

Message Text

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ACTION SS-25

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C O N F I D E N T I A L SECTION 01 OF 02 LONDON 01545 VIPTO 19

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E.O. 11652: GDS
TAGS: OVIP (MONDALE, WALTER F.)
SUBJECT: MEMCON OF MEETING ON ITALIAN ECONOMIC SITUATION

SUMMARY. ON JANUARY 26, WHILE VICE PRESIDENT MONDALE SPOKE PRIVATELY WITH ITALIAN PRIME MINISTER ANDREOTTI, REMAINDER OF U.S. DELEGATION HELD SESSION ON ITALIAN ECONOMIC LEADERS. MAIN POINTS MADE BY ITALIANS CONCERNED GOI EFFORTS TO REDUCE INFLATION AND BALANCE OF PAYMENTS DEFICITS THROUGH ECONOMIC STABILIZATION PACKAGE. U.S. REPS ASSURED ITALIANS OF EFFORTS BEING MADE BY U.S. TO STIMULATE U.S. ECONOMY TOWARD FASTER NON-INFLATIONARY GROWTH AND TO ENCOURAGE GERMANS, DUTCH AND JAPANESE TO DO LIKEWISE. END SUMMARY.

1. THE PARTICIPANTS AT THE MEETING ON THE ITALIAN SIDE WERE: MINISTER OF TREASURY GAETANO STAMMATI, MINISTER OF FOREIGN TRADE RINALDO OSSOLA, GOVERNOR OF THE BANK OF ITALY PAOLO BAFFI, MINISTER OF FOREIGN AFFAIRS ARNALDO FORLANI (CAME LATER), SECRETARY GENERAL OF MINISTRY OF FOREIGN AFFAIRS RAIMONDO MANZINI, ITALIAN AMBASSADOR TO THE U.S. ROBERTO GAJA, AND DIRECTOR GENERAL OF TREASURY SILVANO PALUMBO. ON THE AMERICAN SIDE: UNDER SECRETARY OF STATE COOPER, ASSISTANT SECRETARY OF STATE HARTMANN, /
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ASSISTANT SECRETARY OF TREASURY BERGSTEN, NSC ECONOMIC ADVISER HORMATS, U.S. AMBASSADOR-DESIGNATE GARDNER, AND CHARGE BEAUDRY.

2. TREASURY MINISTER STAMMATI OPENED THE MEETING BY RECOUNTING THE EFFORTS WHICH THE ITALIAN GOVERNMENT IS

MAKING TO DEVELOP AND IMPLEMENT A STABILIZATION PROGRAM TO DECREASE INFLATION, LOWER THE COST OF LABOR AND REDRESS THE BALANCE OF PAYMENTS. STAMMATI SAID THAT IN 1976 THE GDP INCREASED BY OVER 5 PERCENT IN REAL TERMS, DESPITE A SERIOUS INCREASE IN INFLATION. THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS WAS IN DEFICIT FOR THE YEAR BY \$2.5 BILLION AS IMPORTS ROSE BY 33 PERCENT COMPARED TO 27 PERCENT FOR EXPORTS. STAMMATI NOTED THAT IN JANUARY 1976 THE BANK OF ITALY HAD BEEN FORCED TO REMOVE SUPPORT FROM THE LIRA. AFTER THE OFFICIAL CURRENCY MARKET REOPENED BY APRIL, THE GOI FELT COMPELLED TO ADOPT A PRIOR DEPOSIT SCHEME OF 50 PERCENT OF THE COST OF IMPORTS. THIS MEASURE WAS RELUCTANTLY APPROVED BY THE EC PARTNERS AND OTHER INTERNATIONAL FINANCIAL INSTITUTIONS. IN SEPTEMBER THERE WAS ANOTHER LIRA CRISIS AND, IN ADDITION TO THE PRIOR DEPOSIT SCHEME, THE ITALIANS INTRODUCED FOR TWO WEEKS A 10 PERCENT TAX ON FOREIGN EXCHANGE TRANSACTIONS WHICH STOPPED THE RUN ON THE LIRA. ONLY ONE WEEK AFTER THE TAX TERMINATED, IT WAS NECESSARY TO REIMPOSE THE TAX AT 7 PERCENT. IN OCTOBER THE DISCOUNT RATE WAS RAISED TO 15 PERCENT AND QUANTITATIVE CREDIT LIMITS WERE IMPOSED. AT THE END OF DECEMBER THE EXCHANGE TAX BEGAN TO BE REDUCED PROGRESSIVELY STARTING AT 3.5 PERCENT. NONETHELESS, THE LIRA STABILIZED WITH MINOR LOSSES (FROM 865 LIRA PER DOLLAR TO 880).

3. THE PRINCIPAL CAUSES OF THE ITALIAN DIFFICULTIES ARE HEAVY BUDGET DEFICITS BY THE CENTRAL GOVERNMENT AND LOCAL AUTHORITIES PLUS AUTOMATIC WAGE ADJUSTMENTS THAT

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HAVE CAUSED EXCESSIVE INCREASES IN THE COST OF LABOR. IN ORDER TO CONTROL GOVERNMENT SPENDING, WHICH IN PART IS DUE TO DEFICITS IN PUBLIC SECTOR COMPANIES SUCH AS RAILROADS, ELECTRIC POWER, POST OFFICE, ETC., THE GOVERNMENT IS INCREASINGLY IMPOSING MORE REALISTIC CHARGES FOR THESE SERVICES WITH THE IDEA OF REDUCING

GDP (FROM 13,600 BILLION LIRA TO 9,800 BILLION LIRA). A TAX AND PUBLIC SERVICE TARIFF PACKAGE OF ABOUT \$7.8 BILLION HAS BEEN APPROVED (ABOUT 5 PERCENT OF GDP) AND THE GOVERNMENT HOPED TO CONTROL LOCAL GOVERNMENT EXPENDITURES THROUGH ADMINISTRATIVE MEASURES. IN ADDITION, THEY ARE MAKING A STRONG ATTACK ON THE COST OF LABOR. A LAW HAS BEEN PASSED WHICH WOULD PUT ALL SALARY INCREASES UNDER THE SCALA MOBILE (ESCALATOR CLAUSE) FOR THOSE PERSONS MAKING OVER 8 MILLION LIRA ANNUALLY INTO TREASURY BONDS. FOR THOSE PEOPLE EARNING BETWEEN 6 AND

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8 MILLION LIRA, 50 PERCENT OF THEIR SCALA MOBILE
INCREASES GO INTO TREASURY BONDS. THESE FUNDS WOULD THEN
BE USED TO FINANCE INVESTMENTS WHICH WILL INCREASE
EMPLOYMENT.

4. THE ITALIAN AUTHORITIES ARE USING HIGH INTEREST
RATES TO SOP UP EXCESS LIQUIDITY IN THE DOMESTIC ECONOMY.
IMPORTS IN ITALY ARE A FUNCTION OF TOTAL DOMESTIC DEMAND
AND IT IS THEIR AIM TO KEEP THIS DOWN. THEY HAVE AGREED
WITH THE IMF THAT TOTAL DOMESTIC CREDIT EXPANSION WILL
BE LIMITED TO 33,000 BILLION LIRA.

5. SOME DEVELOPMENTS SHOULD BE POSITIVE IN 1977. IT IS
ESTIMATED THAT THE CURRENT ACCOUNT OF THE BALANCE OF
PAYMENTS WILL BE IN SURPLUS BY \$L BILLION. THIS WILL BE
POSSIBLE BECAUSE GROWTH WILL BE REDUCED IF NOT ELIMINATED.
THIS IS A PRICE THE ITALIANS ARE WILLING TO OAY FOR
STABILITY AND BALANCE OF PAYMENTS IMPROVEMENT. STAMMATI
NOTED THAT THE EXTERNAL DEBT NOW AMOUNTS TO ABOUT \$L7
BILLION. IN 1977 ABOUT \$2.3 BILLION IN PRINCIPAL AND
INTEREST PAYMENTS WILL HAVE TO BE MADE: ON PRINCIPAL
\$826 MILLION TO INTERNATIONAL INSTITUTIONS AND \$547
MILLION TO PRIVATE LENDERS AND ON INTEREST \$927
MILLION.

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6. GOVERNOR OF THE BANK OF ITALY BAFFI COMMENTED THAT THE BIG PROBLEMS ARE TO CONTROL LIQUIDITY AND CREDIT, THE PUBLIC SECTOR DEFICIT AND WAGE INCREASES TO REDUCE INFLATION. HE NOTED THAT THE GOVERNMENT IS PUTTING UP WITH HIGH NOMINAL INTEREST RATES AND THAT THIS IS EXPECTED TO ATTRACT RETURN FLOW OF SAVINGS THROUGH THE SALE OF

BILLION WORTH OF TREASURY BILLS WITH ABOUT 75 PERCENT BEING SUBSCRIBED BY INVESTORS OTHER THAN THE CENTRAL BANK. IN ORDER TO PREVENT THE MONETARY BASE FROM BECOMING TOO LARGE, THE ITALIANS HAVE ADOPTED: (A) QUANTATIVE CREDIT LIMITS OF 11 PERCENT, AND (B) FORCED PORTFOLIO INVESTMENT REQUIREMENTS FOR THE BANKS. THE LATTER INVESTMENTS MUST BE IN LONG-TERM SECURITIES. IN EFFECT, THE GOI IS USING A MIXTURE OF COERCION AND TREASURY BILLS PRICES AT 17 PERCENT, WHICH IS CLOSE TO THE INFLATION RATE.

7. MR. COOPER BRIEFLY EXPLAINED HOW THE U.S. ECONOMIC PROGRAM IS DESIGNED TO IMPROVE WORLD ECONOMIC CONDITIONS GENERALLY. HE NOTED THAT PRESIDENT CARTER HAD ANNOUNCED A PLAN TO STIMULATE THE U.S. ECONOMY BY \$15 BILLION IN 1977 AND AGAIN IN 1978. HE NOTED THAT IN OUR VIEW THIS STIMULUS WILL HAVE NO NET INFLATIONARY IMPACT. HE ADDED THAT IT IS NOT JUST OUR EFFORTS BUT THAT WE ARE ENCOURAGING THE GERMANS, DUTCH AND JAPANESE TO ACT IN THE SAME WAY.

8. MR. COOPER ASKED WHAT THE PRESENT DEVELOPMENTS OR PROSPECTS ARE ON THE ITALIAN WAGE SITUATION. HE COMMENTED THAT HIGH AUTOMATIC WAGE ADJUSTMENTS STYMIE THE CLASSIC REMEDIES OF INFLATION. HE ALSO ASKED WHAT THE OUTLOOK WAS FOR WAGE COSTS IN 1977.

9. STAMMATI POINTED OUT THAT THEY HOPED TO REDUCE
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INFLATION AND THEREFORE COST OF LIVING ADJUSTMENTS BY CUTTING OUBLIC SECTOR DEFICIT. THEY WERE NEGOTIATING AGREEMENT IN THE IMF AND EC ON A TREASURY DEFICIT OF 9,800 BILLION LIRA AND WOULD AIM AT REFORM OF LOCAL GOVERNMENT FINANCING WITHIN CONTEXT OF TIGHTER EXPENDITURE CONTROLS. HE SAID THE INCREASE IN UNIT LABOR COSTS INVOLVED NOT BASIC SALARY INCREASES BUT ALSO RAISES SOCIAL INSURANCE COSTS AND LOW PRODUCTIVITY. IN AN EFFORT TO IMPROVE PRODUCTIVITY, THE GOVERNMENT ASKED CONFINDUSTRIA AND THE UNIONS TO FIND A FORMULA WHICH WOULD REDUCE THE INFLATIONARY EFFECTS OF THE SCALA

MOBILE AND THE COST OF LABOR GENERALLY.

10. THIS PHASE OF THE MEETING ENDED AS THE VICE PRESIDENT AND THE PRIME MINISTER JOINED THE GROUP.
(REMAINDER OF MEETING REPORTED SEPTEL.)

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